VZCZCXRO0632
RR RUEHROV
DE RUEHDS #2324/01 2050842
ZNR UUUUU ZZH
R 240842Z JUL 07
FM AMEMBASSY ADDIS ABABA
TO RUEHC/SECSTATE WASHDC 7122
INFO RUCNIAD/IGAD COLLECTIVE
RUCPDOC/DEPT OF COMMERCE WASHDC
RUEHLMC/MILLENNIUM CHALLENGE CORP WASHINGTON DC 0056
RUEANHA/FAA NATIONAL HQ WASHINGTON DC

UNCLAS SECTION 01 OF 02 ADDIS ABABA 002324

SIPDIS

SIPDIS

STATE FOR AF/E, AF/EPS, AND EB/TRA

E.O. 12958: N/A
TAGS: ECON ETRD EINV EAGR EAIR ET
SUBJECT: ETHIOPIA MONTHLY ECONOMIC REVIEW FOR JUNE 2007

REF: A. ADDIS ABABA 777 (NOTAL)
¶B. ADDIS ABABA 421 (NOTAL)

ADDIS ABAB 00002324 001.2 OF 002

¶1. SUMMARY:
-- The GOE approved a federal budget of USD 4.9 billion for fiscal year 2007/08, a 20 percent increase over the previous year.
-- The IMF reports that the Ethiopian economy grew by an average of 10.7 percent annually in the past three years, with 9.4 percent estimated for this year.
-- The official exchange rate of the Ethiopian Birr is depreciating significantly against the U.S. dollar.
-- Ethiopia's central bank announced adjustments on the reserve requirement ratio and the minimum deposit interest rate policy.
-- In May, consumer prices had risen by 17.3 percent over the previous year.
-- Starbucks has agreed to a wide-ranging accord with Ethiopia to support and promote its coffee, ending a long-running dispute.
-- Deutsche Lufthansa AG, Europe's second-biggest airline, has agreed to code-share with state-run Ethiopian Airlines. END SUMMARY.

NEW FEDERAL BUDGET ADOPTED

¶2. On July 7, Parliament approved a USD 4.9 billion federal government budget for FY 2007/08, endorsed earlier by the Council of Ministers on June 13. (NOTE: The Ethiopian fiscal year runs from July 8 to July 7. END NOTE.) The proposed federal budget exceeds the previous year's by 20 percent. According to information obtained from the Prime Minister's office, nearly USD 1.2 billion (24.5 percent) is earmarked for recurrent expenditures, and over USD 2.0 billion (42.2 percent) for capital expenditures. The balance constitutes regional transfers (i.e., from the federal government to Ethiopia's regional states). Additional details will be reported SEPTEL.

IMF HIGHLIGHTS ECONOMIC GROWTH, INFLATION

¶3. The IMF Board of Directors issued a statement on June 15 praising Ethiopia's consecutive economic growth for the past three years as the fastest in Ethiopia's recent history. The IMF said not only had the government registered an annual real per capita increase of 7 percent, but also that economic expansion had significantly contributed to poverty reduction and progress towards the Millennium Development Goals. However, the expansion in the economy is not without challenges: according to the IMF, consumer prices rose by 19 percent in February 2007. Balancing growth with inflationary pressure has become a major preoccupation for the GOE. Fiscal

deficit, pressure on domestic prices, and an economy vulnerable to weather and dependent on development partners, are also factors that pose serious challenges. The IMF states that "a critical challenge for Ethiopia is to accelerate structural reforms to buttress and sustain growth, while maintaining macroeconomic stability."

¶4. The IMF states that the Ethiopian economy grew by an average of 10.7 percent annually in the past three years, with 9.4 percent estimated for this year. The GOE argues that monetary growth, mainly driven by credit expansion, was consistent with growth in nominal GDP. Despite this, however, inflation has been rising over the last two years. Annualized national headline inflation reached 17.3 percent in May 2007, in contrast to 12.3 percent in June 2006 and 8.6 percent in June 2005.

EXCHANGE RATE: DEPRECIATING CURRENCY

¶5. Ethiopia follows a dirty floating exchange rate regime; the IMF called it a crawling peg. The Ethiopian Birr is pegged to the U.S. dollar, and the rate is determined by the daily inter-bank foreign exchange market. The National Bank of Ethiopia (central bank) regulates the foreign exchange market through intervention. Over the past several years, the exchange rate has been slowly and steadily depreciating by about Birr 0.0001 daily. As a result of the pressure on balance of payments problems, the official exchange rate has showed significant depreciation since December 2006. The exchange rate of the Birr against the USD at the end of June 2007 reached 9.03 Birr/USD, in contrast to 8.71 Birr in December 2006, 8.69 Birr in June 2006, and 8.65 Birr in June 2005. The parallel market rate at the end of June 2007 reached 9.30 Birr, reflecting the pressure on the foreign exchange demand. Driven by rising domestic inflation relative to prices of Ethiopia's trading partners, the real effective exchange rate is appreciating, making the country's exports less competitive.

INTEREST RATE DEVELOPMENTS

¶6. The National Bank of Ethiopia (central bank) began determining the maximum lending and minimum deposit interest rates since October
¶1992. Several adjustments have been made to the interest rate policy to induce investment and growth. Since January 1998, the Bank has allowed the lending rate to be determined by market forces, while it continues to control the floor deposit rate. In July 2007, the Bank raised the minimum deposit rate to 4 percent, up from the 3 percent minimum in place since March 2002. Given the double digit inflation rate, however, currently real interest rates are significantly negative. The Bank also raised the legal reserve requirement ratio of commercial banks from 5 to 10 percent of net deposits. The Bank Governor said in a July 4 press release that these policy measures were taken to curb the pressure from prevailing inflation.

PRICES

¶7. Except during some episodes of drought and macroeconomic shocks, Ethiopia has historically been among the low inflation countries in sub-Saharan Africa. Since over 60 percent of the weights in the Consumer Price Index (CPI) constitute food items, the CPI largely depends on performance of agriculture. The trend in the CPI in the past two years was, however, quite contrary to this historic trend. Official statistics indicate that average agricultural value added grew by 14 percent in the past three years, while the annualized headline inflation rate has been steadily rising and reached 17.3 percent in May 2007, in contrast to 12.3 percent a year earlier.

LONG-STANDING ISSUES WITH STARBUCKS RESOLVED

¶8. Starbucks has agreed to a wide-ranging accord with Ethiopia to support and promote its coffee, ending a long-running dispute (REF A) over the issue. The U.S. retailer will market, distribute and, in some cases, license Ethiopia's range of high-quality coffee brands. A row over the recognition and use of trademarks for its coffee had stymied cooperation between the two sides. It is hoped the deal will act as a catalyst to raise the value of coffee exports and thus improve the livelihoods of Ethiopian farmers. The agreement acknowledges Ethiopian ownership of popular coffee designations such as Yirgacheffe, Harar, and Sidamo whether they are registered or not. It will also allow Starbucks to use coffee types in certain markets under agreed conditions. Ethiopian farmers will not receive royalty payments from the deal, but it is hoped that more effective distribution and marketing will help boost demand and, in time, lift prices of exports.

--- -
ETHIOPIAN AIRLINES TO CODESHARE WITH LUFTHANSA
--- -

¶9. Deutsche Lufthansa AG, Europe's second-biggest airline, and state-run Ethiopian Airlines agreed to sell seats on each other's flights to expand their networks. The companies signed a code-sharing agreement on the margins of a July aviation conference in Vancouver. The accord will take effect by mid-year, Lufthansa CEO Wolfgang Mayrhuber said. Ethiopian Airlines CEO Girma Wake has indicated the airline is considering joining either Star Alliance or Oneworld. (COMMENT: Ethiopian Airlines' code-share with Lufthansa is a positive step and will facilitate its code-sharing with United Airlines, via Star Alliance membership; see REF B. END NOTE.)
YAMAMOTO